EXPLANATION OF PROPOSED FINANCE COMMITTEE AMENDMENT TO S. 2238 (TECHNICAL CORRECTIONS ACT OF 1988, AS REPORTED)

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of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a brief description of a proposed committee amendment to S. 2238 (Technical Corrections Act of 1988) as reported by the Senate Committee on Finance.[2]

Part I describes additional technical corrections and modifications of previously adopted technicals. Part II describes four revenue-increase provisions to close certain loopholes. Part III includes certain noncontroversial, low-cost provisions. Part IV describes extensions of expiring tax provisions and certain other substantive provisions.

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[1] This document may be cited as follows: Joint Committee on Taxation, Explanation of Proposed Finance Committee Amendent to S. 2238 (Technical Corrections Act of 1988, as Reported) (JCX-25-88), September 8, 1988.

[2] See S. Rept. 100-445, August 3, 1988.

I. ADDITIONAL TECHNICAL CORRECTIONS AND MODIFICATIONS TO TECHNICAL CORRECTIONS

Corporate Tax Provisions

1. Outbound liquidations. Provide that the technical correction relating to transfers of property to a foreign corporation that would otherwise qualify as a tax-free reorganization would apply only to transactions occurring after June 21, 1988, except that such technical correction would not apply to reorganizations for which a plan of reorganization had been adopted before June 21, 1988.

2. Mirror subsidiary transition rule. The proposal would clarify that, for purposes of the exception from the effective date provision concerning mirror subsidiary transactions in cases where 80 percent of the stock of the distributing corporation is acquired by the distributee, the ownership of distributees which are members of the same affiliated group may be aggregated in certain cases.

3. Section 384 and common control exception. Provide that if the gain corporation, the loss corporation or both were not in existence throughout the five year period, the exception will be applied by substituting the shorter of the periods during which the gain corporation, the loss corporation, or both were in existence.

4. Section 384 and treatment of affiliated corporations. Clarify in legislative history that not only post-affiliation gains or losses, but also pre-affiliation gains or losses which were not limited under section 384, are not subject to the limitations of section 384 upon the merger of members of the same affiliated group.

5. General Utilities repeal and reorganizations of RICs and REITs. Provide that the technical correction clarifying that the Treasury's regulatory authority to ensure that the purposes of General Utilities repeal is not circumvented through the use of REITs or RICs would not apply to any reorganization involving a RIC or REIT if by June 10, 1987: 1) the board of directors of one of the parties to the reorganization adopted a resolution to solicit shareholder approval for the transaction; or 2) the shareholders or the board of directors of one of the parties to the reorganization approved the transaction.

6. General Utilities repeal and reorganizations involving RICs and REITs. The Internal Revenue Service announced that it intends to issue regulations which would require, as of June 10, 1987, that a RIC or REIT disposing of built-in gain assets would not only have to pay a corporate-level tax on the built in gain but also distribute the

proceeds in excess of the corporate-level tax to shareholders. Provide legislative history indicating that the Committee expects the Internal Revenue Service to use its section 7805(b) authority to provide relief to adversely affected taxpayers.

7. Special rule relating to 1976 Act net operating loss limitations. Clarify that warrants would not be treated as stock under section 382 of the 1976 Act.

8. Real Estate Investment Trusts. The provision in the bill treating certain interest rate swap and cap agreements as giving rise to income qualifying under the 95 percent test and as securities under the 30 percent test would not be treated as creating a negative inference as to whether other interest rate swap and cap agreements should be similarly treated.

Insurance Provisions

1. Property and Casualty Insurance Companies. Clarify that the rule of former section 825(g), eliminating loss carryovers of corporations electing to be taxed only on investment income, continues to apply. The provision is effective as if enacted with the Tax Reform Act of 1986.

Compliance

1. Section 6323. Provide that State legislation merely conforming to or reenacting Federal law establishing a national filing system for instruments affecting interests in personal property does not constitute a second office designated by the State for filing notices of Federal tax liens.

2. Section 6332. Extend the immunity from liability of a person honoring an IRS levy to apply not only with respect to the delinquent taxpayer but also any other person.

3. Section 6503. Conform the statute of limitations rule for levies to that for liens so that if a timely proceeding in court for the collection of tax is commenced, the period during which such tax may be collected by levy shall not expire as long as the tax is still collectible.

Minimum Tax Provisions

1. Incentive Stock Options. The bill clarifies that for all purposes of the individual minimum tax, stock acquired pursuant to the exercise of an incentive stock option will be treated as a nonqualified stock option. Provide that the provision in the bill applies only to options exercised after December 31, 1987 (as opposed to October 16, 1987).

Pensions and Deferred Compensation

1. Retirement bond distribution rules. Under the proposal, permissible rollovers from retirement bonds (sec. 409) could be delayed under rules similar to temporary Treasury rules delaying the application of the required distribution rules to IRAs. (Title XI of the 1986 Act)

2. Reporting of dependent care assistance. The bill modifies an employer's obligation to report dependent care assistance. Under the bill, the amount required to be reported for a year with respect to an employee is the amount such employee incurs for dependent care assistance during the year. Under the proposal, an employer may treat an amount electively contributed by an employee under a cafeteria plan for dependent care assistance for a year as an amount incurred for dependent care assistance by such employee for such year. (Revenue Act of 1987)

3. Treatment of plan spin-offs, transfers, etc. The bill provides that, in the case of plan spin-offs and similar transactions (within a controlled group) involving defined benefit plans, assets in excess of the benefits that would have been provided immediately before the transaction (if the plan then terminated) are allocated on a proportional basis. The proposal would provide two exceptions to this rule. First, if pursuant to the plan spin-off or similar transaction, one or more of the defined benefit plans is terminated, such plan or plans would be treated like a plan transferred outside the controlled group and thus would be exempt from the proportional allocation rule. Second, the proportional allocation rule would not apply to a plan that is spun off from a multiple employer plan if, after the spin-off, no employer (or member of the same controlled group) maintaining the multiple employer plan maintains the spun-off plan. (Revenue Act of 1987)

4. Variable rate premium. Under the bill, if no deductible contributions cannot be made to a plan for a plan year because of the full funding limitation, no additional PBGC premium would be required with respect to the plan in the following plan year. The proposal would limit this relief from the additional PBGC premium to situations in which no deductible contributions can be made because of the new 150 percent of current liability component of the full funding limitation. (Pension Protection Act)

5. ERISA, etc., amendments. Under the proposal, generally technical amendments to Titles I and IV of the Employee Retirement Income Security Act of 1974 (ERISA) or to the Public Health Service Act, as well as corresponding amendments to the Internal Revenue Code, and a correction of a date in a transition rule with respect to the effective

date of the Multiemployer Pension Plan Amendments Act of 1980 would be deleted from the bill.

Foreign Provisions

1. Liquidation of possession corporation. Clarify the technical correction in the bill which treats gains derived from the liquidation of certain possession corporations as foreign source, so that the three-year testing period would be applied by reference to the year in which the liquidating distribution occurs, rather than the year in which the liquidation is deemed to occur.

2. Effective date of qualified electing fund election. Provides that, notwithstanding the normal deadline provided in the Code by which a passive foreign investment company must make a qualified electing fund election, the period for making the election will in no event expire before the date 60 days after the date of the enactment of the bill. This technical correction was in the introduced version of S. 2238 and was inadvertently ommitted from the committee-passed bill.

3. Retroactive qualified electing fund election. Provide regulatory authority to allow a passive foreign investment company (PFIC) to make a late qualified electing fund election where the foreign corporation reasonably believed, as of the normal due date for making the election with respect to an earlier taxable year, that it was not a PFIC in that year. This technical correction was in the introduced version of S. 2238 and was inadvertently ommitted from the committee-passed bill.

Tax Exempt Bond Provisions

1. Delation of Technical Correction. The proposal would delete section 113(g)(3)(C) from the bill.

Excise Taxes

1. Aviation fuel used in international flights not subject to LUST tax. Under the Superfund Reauthorization and Amendments Act of 1986, aviation fuel used as supplies in an aircraft in foreign trade was exempt from the LUST tax. The provisions relating to the collection of the diesel fuel excise tax in the Revenue Act of 1987 inadvertently terminated this exemption. The proposal would restore this exemption.

Trusts and Estates

A. Estate Freezes

1. Qualified debt. The provision in the bill requiring

that the fixed maturity date of qualified debt be within 15 years of the date of issue would be eliminated. In addition, the requirement that qualified debt not grant voting rights would be clarified so as to permit voting rights when there is a default as to payment of interest or principal.

2. Study. The Secretary of the Treasury would be directed to perform a study as to whether the appropriate adjustments to be made for the value of the retained interest should reflect the time value of money.

3. Exceptions. The bill would be amended to allow taxpayers to modify (prior to 1/1/90) their debt instruments, agreements, or other retained interests in order to fall within the statutory exceptions.

4. Right of contribution. The bill would be amended so that there would be no right of contribution against a charitable remainder trust for gift and estate tax attributable to the operation of the provision. In addition, where a decedent lacks a will, there would be no right of contribution if the decedent specifically directs in a trust serving as a substitute for a will.

5. Deemed gift. The amount of a gift deemed by virtue of a later transfer by either the original transferor or transferee would be reduced by the value of the transferor's right to recover such tax from the transferee.

B. Generation Skipping Transfer Tax

1. Definition of executor. If there is no executor or administrator appointed, qualified and acting within the United States, then any person in actual or constructive possession of any property of the decedent would be treated as the executor for generation-skipping transfer tax purposes.

Miscellaneous Provisions

1. Treatment of payments from certain mining reclamation programs. Section 118(q)(6) of the bill clarifies the present law exclusion from gross income, under section 126 of the Code, of certain payments received under environmental and conservation programs. The proposal would delete this provision.

2. Basis adjustment for market discount currently included in income. Taxpayers electing to include market discount currently in income would be allowed a basis adjustment for amounts so included.

II. PROVISIONS THAT CLOSE LOOPHOLES

A. Corporate Estimated Tax Speedup

Under present law, corporations are required to make estimated tax payments four times a year. For small corporations, each installment is required to be based on an amount equal to the lesser of (1) 90 percent of the tax shown on the return or (2) 100 percent of the tax shown on the preceding year's return. For large corporations, each installment is required to be based on an amount equal to 90 percent of the tax shown on the return (except that the first payment may be based on 100 percent of the tax shown on the preceding year's return). For both large and small corporations, the amount of any payment is not required to exceed an amount which would be due if the total payments for the year up to the required payment equal 90 percent of the tax which would be due if the income already received during the current year were placed on an annual basis. Any reduction in a payment resulting from using this annualization rule must be made up in the subsequent payment if the corporation does not use the annualization rule for that subsequent payment. However, if the subsequent payment makes up at least 90 percent of the earlier shortfall, no penalty is imposed.

The provision would require a corporation that uses the annualization method for a prior payment to make up the entire shortfall (rather than 90 percent of the shortfall) in the subsequent payment in order to avoid an estimated tax penalty. This provision would change the provision relating to corporate estimated taxes included in S. 2238 as reported by the Finance Committee. The provision would be effective for estimated tax payments required to be made after September 30, 1988.

B. Treatment of Single Premium and Other Investment-Oriented Life Insurance Contracts

Under present law, the undistributed investment income earned on premiums credited under a contract that satisfies a statutory definition of life insurance is not subject to current taxation to the owner of the contract. Death benefits under a life insurance contract are excluded from the gross income of the recipient. Amounts received under a life insurance contract prior to the death of the insured generally are not includible in gross income to the extent that the amounts received are less than the taxpayer's investment in the contract. Amounts borrowed under a life insurance contract generally are not treated as received under the contract and, consequently, are not includible in gross income.

The proposal would modify the treatment of loans and other amounts received under a class of life insurance contracts that are statutorily defined as modified endowment contracts. First, amounts received under modified endowment contracts would be treated first as income and then as recovered basis. In addition, loans under modified endowment contracts and loans secured by modified endowment contracts would be treated as amounts received under the contract. An additional 10-percent income tax would be imposed on certain amounts received that are includible in gross income.

Under the proposal, a modified endowment contract would be defined as any contract meeting the present-law definition of life insurance but failing to satisfy a 7-pay test. A modified endowment contract would also include any life insurance contract received in exchange for a modified endowment contract. A contract that is materially changed would be considered a new contract that is subject to the 7-pay test as of the date that the material change takes effect. The proposal would apply to contracts that are entered into or that are materially changed on or after June 21, 1988.

The proposal is the same as the provision contained in H.R. 4333 as passed by the House with the following clarifications and modifications:

1. Distribution rules

a. The assignment or pledge of a modified endowment contract would not be treated as an amount received under the contract if the assignment or pledge is solely to cover the payment of burial expenses or prearranged funeral expenses and the policyholder does not receive cash directly or indirectly in connection with the assignment.

b. Any amount payable or borrowed under a modified

endowment contract would not be included in gross income to the extent that the amount is retained by the insurance company as a premium or other consideration paid for the contract or as interest or principal paid on a loan under the contract.

c. For purposes of the distribution rules, the cash surrender value of a modified endowment contract would be reduced by the amount of any loan that is treated as received under the contract under the revised income inclusion rules. In addition, the investment in the contract and the cash surrender value of the contract would be increased by the amount of payments on a loan to the extent attributable to loans treated as received under the contract under the revised income inclusion rules.

d. A contract would be considered a modified endowment contract for (1) distributions that occur during the contract year that the contract fails (whether due to a death benefit reduction or otherwise) to satisfy the 7-pay test and all subsequent contract years, and (2) distributions that are made in anticipation of the contract failing to satisfy the 7-pay test as determined by the Treasury Department.

2. 7-pay test

a. The mortality charges taken into account in computing the 7-pay premiums would equal the mortality charges specified in the prevailing commissioners' standard table (as defined in sec. 807(d)(5)) at the time the contract is issued or materially changed (currently 1980 CSO) except to the extent provided otherwise by the Treasury Department (e.g., with respect to substandard risks).

b. In the case of a contract that provides an initial death benefit of $10,000 or less and that requires at least 20 nondecreasing annual premium payments, the amount of the 7-pay premium for each year would be increased by an expense charge of $75. All contracts issued by the same insurance company would be treated as a single contract for purposes of applying this rule.

c. Riders to contracts would be considered part of the base insurance contract for purposes of the 7-pay test.

d. The complete surrender of a life insurance contract during the first 7 years of the contract would not in itself cause the contract to be treated as a modified endowment contract.

e. The lapse of a contract resulting in paid-up insurance in a reduced amount due to the nonpayment of premiums would not be considered in applying the 7-pay test

if the contract is reinstated to the original face amount within 180 days after the lapse.

f. The amount paid under a contract would be reduced by nontaxable distributions to which section 72(e) applies whether or not attributable to a reduction in the originally scheduled death benefit.

3. Material change rules

a. The rule that a death benefit increase must be required in order to satisfy the statutory definition of life insurance would be eliminated.

b. The definition of necessary premium for guideline premium contracts would be modified to allow aggregate premium payments equal to the greater of (1) the guideline single premium or (2) the sum of the guideline level premiums to date (without regard to the deemed cash value). For this purpose, the guideline single premium and the guideline level premiums would be based on the lowest death benefit payable during the first 7 contract years.

c. A decrease in future benefits under a contract would not be considered a material change.

d. Policyholder dividends would be considered other earnings that may increase the death benefit without triggering a material change.

e. The Treasury Department would be granted authority to provide circumstances under which a de minimis death benefit increase is not a material change (e.g., a death benefit increase that is attributable to a reasonable cost of living adjustment determined under an established index specified in the contract).

f. In the case of a contract that is materially changed, the new 7-pay premium would be adjusted to take into account only the cash surrender value of the contract as of the date of the material change.

4. Effective date

a. The proposal would apply to contracts entered into on or after June 21, 1988. A contract would be considered entered into on or after June 21, 1988, if (1) on or after June 21, 1988, one or more of the future benefits under the contract are increased or a qualified additional benefit is increased or added to the contract and, prior to June 21, 1988, the owner of the contract did not have a unilateral right under the contract to obtain such increase or addition

without providing additional evidence of insurability, or (2) the contract has been converted from a term life insurance contract into a life insurance contract providing coverage other than term insurance coverage after June 20, 1988, without regard to any right of the owner under the contract to obtain such conversion.

b. A modified endowment contract that is entered into on or after June 21, 1988, and before the date of enactment and that is exchanged (within 3 months after the date of enactment) for a life insurance contract that satisfies the 7-pay test would not be considered a modified endowment contract if gain (if any) is recognized on the exchange.

C. Repeal of Special Rules Allowing Loss Transfers by Alaska Native Corporations

Corporations established under the Alaska Native Claims Settlement Act may, for taxable years beginning before 1992, file consolidated returns with subsidiary corporations under rules more liberal than the generally applicable rules. In addition, during this period no provision or principle of law may be applied to prevent use of losses or credits of an Alaska Native Corporation by its consolidated group. The effect of these provisions is to allow Alaska Native Corporations to transfer the benefit of their tax losses and credits to other corporations, which use the losses or credits to reduce their tax liability.

Under the proposal, the special consolidation rules applicable to Alaska Native Corporations (including the rule prohibiting denial of the use of losses or credits through application of any provision or principle of law) would be repealed.

The provision would be effective for losses and credits arising after April 26, 1988. In addition, losses and credits of an Alaska Native Corporation arising before that date could not be used to offset income assigned (or attributable to property contributed) on or after that date, unless such use would be allowable without regard to the special consolidation rules.

In addition, if an Alaska Native Corporation has not engaged in any loss transfer transaction prior to April 26, 1988, up to $5 million of losses and credits of such Alaska Native Corporation arising before December 31, 1988, may be used to offset income assigned (or attributable to property contributed) on or before December 31, 1988. The intention is to provide a period during which Alaska Native Corporations that have never undertaken a loss transfer transaction under the special rules may do so, subject to a limitation on the amount of losses that may be transferred.

D. Modification of Distilled Spirits Flavors Credit

Credit is allowed against the distilled spirits tax for the alcohol content of a taxable beverage that is derived from wine or from flavor components (sec. 5010). The wine credit is equal to the difference between the distilled spirits tax rate ($12.50 per proof gallon) and the tax rate applicable to wine (based on alcohol content). The flavors credit may not exceed 2.5 percent of the alcohol content of the beverage, and is equal to the amount of the distilled spirits tax. The proposal would limit the flavors credit to cases where the flavors remain in the distilled spirits beverage after completion of all distillation. (No change would be made to the wine credit.)

The proposal would be effective for distilled spirits removed after the date of enactment.

III. NONCONTROVERSIAL, LOW COST PROVISIONS

A. Corrections Affecting Agriculture

1. Special use valuation of farm property for estate tax purposes

Under present law, if the executor so elects, the value of real property used as a farm or in another trade or business is its value in such use. A recapture tax is imposed if the property ceases to be used in its qualified use within 10 years (15 years for individuals dying before 1982) after the death of the person in whose estate the property was specially valued. Under the proposal, a surviving spouse's cash rental of specially valued real property to a member of the spouse's family would not result in imposition of the recapture tax.

The proposal would be effective for rentals occurring after December 31, 1976.

2. Discharge of indebtedness income of rural mutual or cooperative utility companies

Under present law, a mutual or cooperative telephone, electric or water company qualifies for exemption from Federal income taxation if at least 85 percent of its gross income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. Gross income of a taxpayer generally includes income from discharge of indebtedness (sec. 61(12)). Under the provision, the 85-percent test of section 501(c)(12) is to be determined without regard to any discharge of indebtedness income arising pursuant sales of indebtedness under section 1001 of the Budget Reconciliation Act of 1986.

3. Treatment of livestock sold on account of drought

Under present law, a cash method taxpayer whose principal trade or business is farming and who is forced to sell certain livestock due to drought conditions may elect to include any income from the sale of the livestock in the taxable year following the taxable year of the sale. This one year elective deferral of income is available only if the livestock would not have been sold in the taxable year but for the drought and the drought conditions resulted in the area being designated as eligible for Federal assistance. The proposal would extend the present-law provision to cattle, horses, and other livestock held for draft, breeding, dairy or sporting purposes. The proposal would apply to sales and exchanges occurring after December 31, 1987.

4. Exemption from payroll tax for certain agricultural workers

The provision would exclude cash wages paid to certain agricultural labors. The provision would be effective as if included in the Omnibus Budget Reconciliation Act of 1987.

To be eligible for the FICA tax exclusion the individual must (1) be employed in agriculture, (2) be a hand harvest laborer, (3) be paid on a piece-rate basis, (4) be paid piece-rates in an operation which has been, and is customarily and generally recognized as having been paid on a piece-rate basis in the region of employment, (5) commutes daily from his permanent residence to the farm on which he is so employed, and (6) has been employed in agriculture less than 13 weeks during the preceding calendar year.

B. Pension and Employee Benefits

1. Employee benefit nondiscrimination rule modifications: church plans and cafeteria plans

The Tax Reform Act of 1986 provided nondiscrimination rules applicable to statutory employee benefit plans maintained by any employer, including an employer that is a tax-exempt organization (sec. 89). The proposal would provide that the nondiscrimination requirements of section 89 do not apply to statutory employee benefit plans maintained by a church for church employees. For purposes of this proposal, the definition of a church would be the same definition that applies for purposes of exclusion from FICA taxes (sec. 3121(w)(3)). Thus, the term "church" would include (1) a convention or association of churches, (2) an elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches, and (3) any church-controlled tax-exempt organization that does not receive substantial support from governmental sources or sales of goods or services. The proposal would be effective as if included in the Tax Reform Act of 1986.

Under present law, life insurance that is funded prior to retirement under a cafeteria plan but provided after retirement is tested for discrimination when provided. Under the proposal, such life insurance would be tested for discrimination when it is funded, based on the amount of life insurance that could at that time be purchased (assuming section 79(c) table costs) with the cafeteria plan elective contributions. This proposal would be effective as if it were part of the provision added by the Tax Reform Act of 1986 allowing post-retirement life insurance to be funded under a cafeteria plan.

Under present law, available elective contributions under a cafeteria plan may not be taken into account for purposes of the 90-percent/50-percent test under section 89. The prior committee amendment allows an employer, under certain circumstances, to take into account all available elective contributions for this purpose. The requirement that an employer either take into account all available elective contributions or none of such contributions can create unintended difficulties in certain situations. Thus, under the proposal, an employer may establish a limit on the amount of available elective contributions taken into account with respect to each employee covered under a cafeteria plan. This is consistent with the original intent of the 90-percent/50-percent test, i.e., that it be focused on available nonelective contributions. This provision would be effective as if it were enacted as part of section 89 in the Tax Reform Act of 1986.

The bill provides that for purposes of applying the nondiscrimination rules of section 89, an employer generally may treat the contribution it makes to a multiemployer plan on behalf of an employee as the benefit provided to the employee under such multiemployer plan. Under the proposal, it would be clarified that an employer may value benefits provided under a multiemployer plan under the generally applicable valuation rules without regard to the special rule provided under the prior committee amendment. This provision would be effective as if it were enacted as part of section 89 in the Tax Reform Act of 1986.

The proposal would clarify in legislative history that under present law the nondiscrimination tests that apply to dependent care assistance programs, other than the concentration test (sec. 129(d)(4)) and the benefits test (sec. 129(d)(8)), apply only to the availability of the program, not to the utilization of the program. This proposal would be a clarification of present law retroactive to the addition of the relevant nondiscrimination tests.

2. Modification of section 403(b) nondiscrimination rules

The Tax Reform Act of 1986 generally applied the qualified pension plan coverage and nondiscrimination rules to the nonelective and matching contributions or benefits of tax-sheltered annuity programs, generally effective for plan years beginning after December 31, 1988. The proposal would modify these nondiscrimination rules in the following manner: (1) student employees who are not taken into account for employment tax purposes may be disregarded; (2) adjunct professors and other part-time employees could be disregarded if they normally work less than 20 hours per week; and (3) the nondiscrimination tests could be applied by testing at the level of the institution that maintains the plan, as long as the institution functions as, and has been historically recognized as, a separate employer. The proposal also would clarify that the special rules applicable to multiple employer pension plans (sec. 413(c)) for purposes of determining whether certain rules are required to be satisfied on an employer-by-employer or on an aggregate basis are applicable to multiple employer tax-sheltered annuity programs. In addition, for plan years beginning before January 1, 1992, the nondiscrimination rules could be applied by testing with respect to a statistically valid sample of employees.

The proposal would be effective as if included in the Tax Reform Act of 1986.

3. Provide that plans of police and firefighters are tested separately for purposes of the minimum participation rule

Under present law, a pension plan is not a tax-qualified plan unless it benefits no fewer than the lesser of (1) 50 employees of the employer, or (2) 40 percent of all employees of the employer. Under the proposal, a plan maintained by a governmental employer for police and firefighters, which are structured generally to take into account the early retirement ages of such employees, would satisfy the minimum participation rule if the plan satisfied the rule taking into account only the employees of the employer who are police and firefighters. Similarly, police and firefighters would not be taken into account in applying the minimum participation rule to coverage of employees of the employer who are not police or firefighters.

The proposal would be effective as if included in the Tax Reform Act of 1986.

4. Gift tax treatment of joint and survivor annuities

Under present law, a taxable gift occurs with respect to a joint and survivor annuity when the donor irrevocably designates a beneficiary. A gift of such an annuity to a spouse may not qualify for the marital deduction because the spouse's interest may terminate and pass to the donor without incurring transfer tax. Under the proposal, the transfer to a spouse of an interest in a joint and survivor annuity in which no person other than a spouse has the right to receive any payments prior to the death of the last spouse to die would, unless otherwise elected, qualify for a marital deduction for Federal estate and gift tax purposes under the rules governing qualified terminable interest property.

The proposal generally would be effective for decedents dying, and transfers made, after December 31, 1981.

5. Allow rural telephone cooperatives to establish section 401(k) plans

Under present law, State and local governments and other tax-exempt organizations (other than rural electric cooperatives) may not maintain section 401(k) plans (cash or deferred arrangements). The proposal would permit rural telephone cooperatives to maintain section 401(k) plans on the same basis as rural electric cooperatives, effective for years beginning after the date of enactment.

6. Employee leasing safe harbor rule

Under present law, certain employees of a leasing organization are considered employees of the service recipient for purposes of certain pension and employee benefit rules. Under a safe harbor rule, a service recipient is not required to maintain records with respect to leased employees if, among other things, less than 5 percent of the recipient's workforce are leased employees (determined in a simplified manner). The proposal would provide that certain individuals would not be considered leased employees of a service recipient that would satisfy the 5-percent test if the percentage were raised from 5 percent to 10 percent. The exempted individuals would include any individual who (1) is credited with less than 3,000 hours of service for the service recipient over any two consecutive calendar years, and (2) did not perform services (as an employee or otherwise) for the service recipient within the same geographic area at any time within the calendar year immediately preceding the two-calendar-year period.

The proposal would be effective as if included in the Tax Reform Act of 1986.

7. Limitations on contributions and benefits under qualified pension plans maintained by public employers

Present law (sec. 415) provides overall limits on contributions and benefits under qualified pension plans maintained by any private or public employer or by related employers. Present law provides special rules applicable to a governmental pension plan and special rules applicable to benefits provided to police and firefighters. Under the proposal, in the case of a plan maintained by a State or local government, the limitation on benefits under a defined benefit pension plan would be the greater of (1) the normal limit on benefits (sec. 415(b)) or (2) the accrued benefit of a participant determined without regard to any benefit increases adopted after October 14, 1987. The proposal would only apply to individuals who are participants before January 1, 1990. In addition, to qualify for this special limitation, the employer maintaining the plan would be required to elect to satisfy the general requirements of section 415 without regard to the special rules for public plans (other than the special rules for police and firefighters). This election could be made indirectly through the modification of the plan maintained by governmental employers.

The proposal would be effective with respect to years beginning after December 31, 1982, and the employer's election would be required by the close of the first plan year beginning after December 31, 1989.

8. Treatment of church self-insured death benefit plans as life insurance

The definition of life insurance created as part of the Deficit Reduction Act of 1984 called into question the income tax exclusion for death benefits that some churches provide for their ministers and lay workers. Under the proposal, the term life insurance generally includes certain church self-funded death benefit arrangements otherwise satisfying the definition of life insurance, even if the arrangements do not constitute life insurance under applicable State law.

The proposal would be effective as if included in the Deficit Reduction Act of 1984.

9. Study of effects of minimum participation rule

Under the Tax Reform Act of 1986, a qualified retirement plan must cover at least the lesser of (1) 50 employees, or (2) 40 percent of the employees of the employer (sec. 401(a)(26)). Federal law requires government contractors to provide certain employees specified retirement benefits or make a specified level of contributions to retirement plans. In some cases where these requirements apply, such as the construction industry, individuals change employers frequently. In order to provide the specified benefits and address the problem of frequent job changes, some employers have established a multiple employer plan covering the affected employees, while maintaining other qualified retirement plans for employees not subject to the Federal requirements. The proposal would require the Treasury Department to perform a study of the effects of the new minimum participation rule on arrangements of this type. The study should consider (1) the Federal requirements with respect to employee benefits for employees of government contractors, (2) whether a special minimum participation rule should apply to multiple employer plans where such Federal requirements apply, and (3) ways in which the plans of employers subject to such requirements could be modified to satisfy the minimum participation rule.

The study would be required to be completed by September 1, 1989.

C. Exempt Organizations

1. Effective date for UBIT treatment of income from certain games of chance

The Deficit Reduction Act of 1984 provided that the unrelated business income tax (UBIT) does not apply to income of a tax-exempt organization derived from conducting a game of chance in a State having a statute, in effect as of October 5, 1983, providing that only nonprofit organizations could conduct such activities; this provision applied to such income derived after June 30, 1981. However, the technical corrections title of the Tax Reform Act of 1986 specified that the only State law to which the 1984 Act provision was intended to apply was a particular North Dakota law. Accordingly, such income derived in other States that tax-exempt organizations had treated as not subject to UBIT pursuant to the 1984 Act was retroactively treated as taxable.

The provision would make the 1986 Act technical correction effective beginning October 22, 1986 (the date of enactment of the technical correction). As a result, the treatment of income derived by tax-exempt organizations from games of chance conducted prior to that date would be governed by the provision of the 1984 Act as originally enacted.

2. Purchasing of insurance by tax-exempt hospital service organizations

Section 501(e) provides tax-exempt status for hospital service organizations operated solely to perform, on a centralized basis, one or more specifically enumerated services. The specifically enumerated services are: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel services. The provision would clarify that purchasing by a hospital service organization includes the acquisition, on a group basis, of insurance (such as malpractice and general liability insurance) for its hospital members.

The provision would be effective upon enactment.

3. **Exempt charitable relief cargo from harbor maintenance tax**

Under present law, the harbor maintenance tax is 0.04 percent of the value of the commercial cargo loaded or unloaded at a U.S. port. The proposal would provide an exemption from the harbor maintenance tax for cargo donated for humanitarian and development assistance overseas, where such cargo is owned or financed by a non-profit organization or cooperative and where the Customs Service certifies that the cargo is, in fact, intended for donation overseas.

The proposal would be effective on April 1, 1987 (the effective date of the tax).

4. Exemption from BATF distilled spirits occupational tax for certain persons receiving spirits tax-free for research purposes

An annual occupational tax of $250 is imposed on persons dealing in specially denatured distilled spirits (and ethyl alcohol), including persons using these distilled spirits for research purposes. The proposal would exempt from this occupational tax State and local government and section 501(c)(3) educational organizations that purchase 25 gallons or less of these spirits in the year for which tax otherwise would be due.

The proposal would be effective on July 1, 1989.

5. Treatment of certain payments to colleges for right to purchase athletic tickets

Pursuant to IRS guidelines, if a payment to or for a college (e.g., to the college's athletic scholarship program) entitles the payor to purchase seating at the college's athletic stadium, the payment is not deductible as a charitable contribution if such tickets would not have been readily available to the taxpayer without making the payment.

Under the provision, if a taxpayer makes a payment to or for a college that would be deductible as a charitable contribution but for the fact that the taxpayer thereby receives (directly or indirectly) the right to purchase seating in the college's athletic stadium, 80 percent of such payment would be treated as a charitable contribution, whether or not tickets would have been readily available to the taxpayer without making the payment. No amount paid for the actual purchase of tickets would be deductible as a charitable contribution; the provision would not apply if the taxpayer receives tickets or seating (rather than the right to purchase tickets) in return for the payment.

The provision would apply to amounts paid in taxable years beginning after December 31, 1983 (i.e., beginning with the year in which the original IRS ruling on this issue was published).

D. Administrative Provisions

1. Certain repairs not treated as manufacturing for retail truck excise tax

A 12-percent retail excise tax is imposed on new heavy trucks. The proposal would establish a 75-percent of value (ratio of repair cost to retail price of a comparable new truck) safe harbor for determining when repairs were so extensive as to constitute manufacture of a new truck.

The proposal would be effective on January 1, 1988.

2. Certain tolerances permitted in determination of wine excise tax

An excise tax ranging from $0.17 cents per wine gallon to $3.40 per wine gallon is imposed on wine. The applicable rate depends on the alcohol content of the beverage. The proposal would authorize the Treasury Department to prescribe de minimis tolerances for the amount of wine contained in commercial containers. If the amount of wine in a container was within these tolerances, tax would not be collected for any excess wine actually in the container. (An identical rule currently applies to the beer excise tax.)

The proposal would be effective on January 1, 1989.

3. Gasoline wholesalers permitted to claim refunds on behalf of certain exempt users

The gasoline excise tax is imposed on removal of gasoline blend stocks from the refinery or bonded pipeline terminal. Exemptions from the tax generally are realized by means of refunds (or credits against other taxes) following tax-paid sales. Refiners and terminal operators (as taxpayers) are allowed to claim the refunds on behalf of many exempt users.

The proposal would allow wholesale distributors (defined as under the diesel fuel tax provisions) to claim gasoline tax refunds for exempt users on the same basis as refiners and terminal operators may do under present law.

The proposal would be effective after September 30, 1988.

4. Election to treat passive foreign investment company (PFIC) stock as stock in a qualified electing fund

A taxpayer's gain from the sale of stock in a passive foreign investment company (PFIC) and certain income received from a PFIC are generally treated as if earned over the period that the stock was held by the taxpayer. An interest charge is imposed on any deferred taxes: that is, taxes attributable to income that is treated as earned in previous years. Under present law, income and gains with respect to PFIC stock are not subject to deferred tax and interest rules if the PFIC has elected to be treated as a qualified electing fund and certain other requirements are met.

Under the proposal, the election to be subject to the qualified electing fund rules would be made at the U.S. shareholder level, on a shareholder by shareholder basis, rather than at the company level. The shareholder election would be available, however, only where the PFIC complied with appropriate requirements (as prescribed by regulation) to determine the income of the company and other information necessary to carry out the PFIC provisions. The proposal would be effective for taxable years beginning after December 31, 1986.

5. Election by parent to claim unearned income of dependent on return

Under present law, the unearned income of a child under the age of 14 in excess of a specified amount is taxed to the child at the top marginal rate of his or her parents. A dependent child with any unearned income must file a tax return if his or her total income exceeds $500. Under the proposal, a parent generally would be permitted to elect to include certain unearned income of a child under the age of 14 on the parent's income tax return if the income of the child is less than $5,000 and consists entirely of specified types of unearned income (interest, dividends, and Alaska Permanent Fund dividends). The election could not be made if estimated tax payments for the taxable year are made in the child's name and social security number.

The proposal would be effective for taxable years beginning after December 31, 1988.

6. Change in due date of GAO trade study

Section 8008 of the Omnibus Trade Act of 1988 requires the General Accounting Office (GAO) to complete a study of four aspects of the Small Business Innovation Research Program by December 31, 1988. The proposal would give the GAO six additional months, until July 1, 1989, to complete this study.

7. Disclosure of return information to certain cities

Present law provides that the IRS can disclose otherwise confidential tax returns and return information to local tax administrators of any city with a population in excess of 2 million that imposes an income (or wage) tax. The provision would apply this provision to cities that impose an income (or wage) tax with populations in excess of 250,000. The provision would be effective on the date of enactment.

E. Tax-Exempt Bonds

1. Calculation of qualified mortgage bond purchase price limit for residences located on certain land subject to ground leases

Residences financed with tax-exempt qualified mortgage bonds must have purchase prices of 90 percent or less of the average area purchase price, determined including the acquisition cost of land. The value of land held subject to a ground lease is determined by capitalizing the value of the lease payments, discounted by the yield on the underlying tax-exempt bonds.

The proposal would direct the Treasury Department to amend its regulations to provide a method of determining a capitalized value for ground leases where the lease term has at least 35 years remaining and the rent is known for at least the first 10 years of the remaining term, but not the entire term.

The proposal would be effective on the date of the bill's enactment, for bonds issued after the date of the bill's enactment.

2. Application of the security interest test to bond financing of hazardous waste clean-up funds

State and local governments may issue tax-exempt bonds to finance governmental activities, but may issue tax-exempt private activity bonds only for specified purposes. Several States are considering issuance of tax-exempt bonds to finance hazardous waste clean-up activities. Present law is unclear as to when these bonds are governmental bonds if the proceeds are used to finance activities on private property and if reimbursement may be sought from private parties. The proposal would direct the Treasury Department to give top priority to issuance of a ruling concerning the application of the private activity bond test to tax-exempt bond financing for State programs.

3. Calculation of income limits for qualified mortgage bond financed homes in high housing cost areas

Purchasers of houses financed with tax-exempt qualified mortgage bonds must have incomes of 115 percent or less of the higher of area or State median income in statistical areas other than targeted areas of economic distress.

The proposal would provide a third alternative for establishing the income limit in high housing cost areas. In these areas, this alternative would adjust the income limit upward from 115 percent of area median income by one percent for each percent that the ratio of local housing cost to income exceeds 120 percent of the same ratio determined nationally. The maximum adjusted income limit would be 140 percent of area median income.

The proposal would apply to bonds issued after December 31, 1988.

4. Tax-exempt financing for certain high-speed rail facilities

Exempt-facility bonds are tax-exempt bonds issued to finance airports, docks and wharves, mass commuting facilities, and sewage facilities among other facilities. With the exception of bonds for airports and docks and wharves, exempt-facility bonds are subject to State private activity volume limitations.

The proposal would create a new category of exempt-facility bonds: bonds to finance intercity high-speed rail facilities. These bonds would receive treatment similar to that currently accorded to bonds issued for airports. The proceeds of such bonds could be used to finance the construction or purchase of terminal facilities, roadbed, rails or other fixed guideway, and any necessary right of way. The proceeds could not be used to purchase rolling stock.

To qualify as a high-speed rail facility it would have to be reasonably expected that trains carrying passengers will be able to operate at average speeds in excess of 150 miles per hour between scheduled stops. Twenty-five percent of the bonds issued must receive State private activity volume cap allocation. Also, high speed rail facilities need not be governmentally owned, but any private owner would have to make an irrevocable election not to claim depreciation or any tax credit with respect to the bond financed property. In addition, any proceeds not spent within three years of the date of issue would have to be used to redeem outstanding bonds.

The proposal would be effective for bonds issued after the date of the bill's enactment.

5. **Application of arbitrage rebate requirement to bona fide debt service funds**

Issuers of tax-exempt bonds are required to rebate to the Federal Government arbitrage earnings on investments unrelated to the purpose of the borrowing. At the election of the issuer, no rebate is required with respect to arbitrage earnings on certain small current debt service funds (i.e., funds where gross earnings are less than $100,000). The proposal would eliminate the $100,000 earnings limit for fixed-rate governmental bonds having a weighted average maturity of five years or more.

The proposal would apply to bonds issued after the date of the bill's enactment. Issuers of outstanding governmental fixed rate bonds would be allowed a one-time election to apply the new rule in the proposal to amounts deposited after the date of the bill's enactment in bona fide debt service funds issued after August 31, 1986.

F. Miscellaneous Provisions

1. Net operating loss rules for bankruptcy: certain ownership changes not counted

The net operating loss limitations of the 1986 Act do not apply to an ownership change resulting from certain bankruptcy reorganizations or proceedings if a petition in the case was filed with a court before August 14, 1986. When stock of a corporation is acquired during the pendency of a bankruptcy, an ownership change may occur and losses may be limited. Under the proposal, under regulations to be prescribed by the Treasury, if any stock that was acquired by shareholders during the proceeding in a transaction that triggered an ownership change does not in fact represent more than 50 percent of the value of the corporation (based on the value of the stock immediately after the completion of the bankruptcy proceeding), an amended return could generally be filed with respect to prior years for which losses were limited (without regard to the otherwise applicable statute of limitations).

The proposal would be effective as if included in the Tax Reform Act of 1986.

2. Foreign currency transactions

Under present law, uniform residence-based sourcing and ordinary income and loss characterization rules apply to certain gains and losses on foreign currency-related forward contracts, futures contracts, options, and similar financial instruments, unless those instruments are marked to market under section 1256 at year-end. At the taxpayer's election, gain or loss on a forward, futures, or option which is a capital asset in the hands of the taxpayer, is not part of a straddle, and is identified by the taxpayer before the close of the day on which it is entered into, is capital, and not ordinary.

Under the proposal, foreign currency gains and losses from transactions in forwards, futures, options, and similar financial instruments would be sourced on the basis of the taxpayer's residence, and unless the capital gain election were applicable, would be treated as ordinary income, without regard to whether the instruments are or would be marked to market under section 1256 if held at year end. The proposal would relax the identification and anti-straddle conditions on making the capital gain election in the case of certain traders.

The proposal would be effective for transactions acquired or entered into after date of committee action.

3. Dual resident companies

Prior to the 1986 Act, certain U.S. corporations subject to income tax in a foreign country on their income without regard to its source or on a residence basis (so-called "dual resident companies") could consolidate with one set of affiliates in the United States and another set in a foreign country simultaneously. In these cases, a dual resident company with a net loss could use that loss to reduce the taxes on two separate streams of income.

The 1986 Act prevents the double use of losses that prior law allowed. Thus, a loss of a dual resident company may in some cases be used to reduce the taxes on income of other members of its foreign affiliated group, but not of its U.S. affiliated group. Under U.S. and U.K. law, however, there are cases in which the loss of a dual resident company with U.K. residence may not be used to offset the income of any other affiliate, U.S. or foreign. In order to restore the use of its losses in the United Kingdom, such a company must reorganize as a U.K. corporation. However, such a reorganization may be a taxable event if the U.S. parent of the dual resident company has an "excess loss account" with respect to the stock of the dual resident company. An excess loss account is created in the stock of a U.S. corporation when losses derived by, and distributions from, that U.S. corporation are in excess of its parent's basis in its stock.

Under the proposal, a U.S. corporation with respect to whose stock there is an excess loss account which arose prior to January 1, 1988 and while the corporation was a dual resident company would be allowed to reorganize as a new foreign corporation without triggering the potential tax associated with the excess loss account. Instead, the excess loss account would be suspended until the stock in the new foreign corporation is disposed of outside of the affiliated group. In addition, rules would be provided so that the new foreign corporation's income is subject to full U.S. tax jurisdiction until the excess loss account is reduced to zero or is recaptured. The proposal is effective for transactions occurring after date of enactment.

4. Carryover of nonconventional fuels credit under minimum tax

Under present law, the nonconventional fuels credit (sec. 29) may not reduce the taxpayer's net income tax to less than the amount of the minimum tax. Carryovers of unused credits are not allowed. Under the proposal, the minimum tax credit allowable in future years against the regular tax will be increased by the amount of the nonconventional fuels credit not allowed for the taxable year solely by reason of the limitation based on the taxpayer's minimum tax liability.

The proposal would apply to taxable years beginning after December 31, 1986.

5. Treatment of certain pledged installment obligations

Under present law, if any indebtedness is secured directly by an installment obligation that arises out of the sale of non-farm real property that is used in a taxpayer's trade or business or that is held for the production of rental income where the selling price of the real property exceeds $150,000 (a "nondealer real property installment obligation"), the net proceeds of the secured indebtedness are treated as a payment on the installment obligation. This rule generally applies to nondealer real property installment obligations that are pledged as security for a loan after December 17, 1987.

Under the proposal, the refinancing of an indebtedness that was outstanding on December 17, 1987, and that was secured by a nondealer real property installment obligation on such date is to be treated as a continuation of the indebtedness and, consequently, will not result in a deemed payment with respect to the installment obligation if (1) the taxpayer is required by the creditor to refinance the loan, and (2) the refinancing is provided by a person other than the creditor or a person related to the creditor. This exception to the deemed payment rule would not apply to the extent that the principal amount of the indebtedness resulting from the refinancing exceeds the principal amount of the refinanced indebtedness immediately before the refinancing. In addition, if the term of the indebtedness resulting from the refinancing exceeds the term of the refinanced indebtedness, upon the expiration of the term of the refinanced indebtedness, the outstanding balance of the indebtedness resulting from the refinancing is to be treated as a deemed payment with respect to the installment obligation.

6. Treatment of stock held in trust in determining whether certain corporations may use the cash method of accounting

Under present law, qualified personal service corporations are excepted from the general rule denying the use of the cash method of accounting to a C corporation or a partnership with a C corporation as a partner. A qualified personal service corporation is a corporation that satisfies both a function test and an ownership test. The ownership test is satisfied if substantially all (i.e., 95 percent or more) of the value of the outstanding stock is owned, directly or indirectly, by certain employees, certain retired employees, the estates of such employees or retired employees, and other persons who acquire stock in the corporation by reason of the death of such employees or retired employees.

The proposal would require the Treasury Department to issue regulations that provide to what extent stock owned by non-grantor trusts is to be treated as indirectly owned by the beneficiaries of the trust for purposes of the ownership test.

The proposal would be effective as if included in the Tax Reform Act of 1986.

7. Above-the-line deduction for jury pay that employee must surrender to employer

Under present law, unreimbursed employee business expenses generally are allowed only as itemized deductions. Also, the total of all miscellaneous itemized deductions, including such unreimbursed employee business expenses, is deductible only to the extent exceeding two percent of the taxpayer's adjusted gross income. If an employer requires its employees to surrender to the employer amounts received as jury pay, in return for continuing the employee's normal salary while on jury service, the amount of surrendered jury pay is deductible only by itemizers, and only to the extent exceeding the two-percent floor.

The provision would provide an above-the-line deduction for jury pay surrendered to the employer as described above. Thus, the deduction would be available to both itemizers and nonitemizers, and would not be subject to the two-percent floor.

The provision would be effective for taxable years beginning after December 31, 1986 (the effective date of the 1986 Act provisions relating to employee business expenses).

8. Minimum tax treatment of structured settlement arrangements

Under present law, the income earned on annuity contracts that are qualified funding assets under structured settlement arrangements is included in the adjusted current earnings of a corporation, under the corporate alternative minimum tax. The proposal provides an exclusion from the adjusted current earnings of a corporation for income on annuity contracts that are qualified funding assets (without regard to whether there is a qualified assignment), effective for taxable years beginning after December 31, 1989.

9. Repeal of general creditor requirement for certain personal injury liability assignments

Under present law, an exclusion from gross income is provided for amounts received for agreeing to a qualified assignment to the extent that the amount received does not exceed the aggregate cost of any qualified funding asset. The terms of the liability assignment are required to satisfy certain qualifications, for the assignment to be a qualified assignment. The qualifications include, among others, the requirement that the assignee does not provide to the recipient of the periodic payments under the liability assignment any rights against the assignee which are greater than those of a general creditor.

Under the proposal, a liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor. The proposal provides that no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor. The proposal would be effective for liability assignments after the date of enactment.

10. Cost of living allowances for judicial branch employees

Under present law, civilian officers or employees of the U.S. government stationed outside the contiguous 48 states and the District of Columbia can exclude from gross income cost-of-living allowances received in accordance with regulations approved by the President. Cost-of-living allowances paid to federal court employees of the U.S. government (after October 12, 1987) are not received under regulations approved by the President and are not excludable from gross income.

Under the proposal, judicial branch employees stationed outside the contiguous 48 states and the District of Columbia would exclude from gross income cost-of-living allowances received after October 12, 1987, if they were received either under regulations approved by the President or under certain other approved pay scales or salary plans.

11. Medical expense deduction for costs of service animals to assist handicapped individuals

IRS rulings specifically provide that amounts paid to acquire, train, and maintain a dog for the purpose of assisting a blind or deaf taxpayer or dependent are eligible for the itemized deduction for medical expenses (Rev. Rul. 55-261, 1955-1 C.B. 307; Rev. Rul. 68-295, 1968-1 C.B. 92). The legislative history of the bill would clarify that under present law, similar costs incurred with respect to a dog or other service animal in order to assist individuals with other physical disabilities similarly would be eligible for the medical expense deduction.

IV. EXTENSION OF EXPIRING TAX PROVISIONS AND OTHER SUBSTANTIVE PROVISIONS

A. Taxpayer Bill of Rights[1]

(1) Disclosure of rights of taxpayers

Under present law, there is no statutory requirement that the IRS provide a written explanation of the rights of the taxpayer and the obligations of the IRS during the tax dispute resolution process. The provision would require the IRS, when it contacts a taxpayer concerning the determination or collection of any tax, to provide a written explanation of the rights of the taxpayer and the obligations of the IRS during the audit, appeals, refund, and collection processes. The IRS would be required to prepare the written explanation not later than 180 days after enactment.

(2) Procedures involving taxpayer interviews

Under present law, the IRS is required to select a reasonable time and place for an examination of a taxpayer (but no regulations have been promulgated elaborating on this provision), and there is no statutory provision governing audio recordings of IRS interviews. The provision would require the IRS to publish within one year of enactment regulations enumerating standards for determining whether the selection of a time and place for interviewing a taxpayer is reasonable. Prior to initial audit or collection interviews, IRS employees would be required to explain the audit or collection process and taxpayers' rights under that process. A taxpayer would be permitted, upon advance notice to the IRS, to make an audio recording of any in-person interview at the taxpayer's own expense. Taxpayers also would be permitted to be represented during an interview by any attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person currently permitted to represent the taxpayer before the IRS. If a taxpayer clearly states during an interview that he or she wishes to consult with a representative, the interview would have to be suspended to afford the taxpayer a reasonable opportunity to consult with the representative. Absent an administrative summons, a taxpayer could not be required to accompany the representative to an interview. The provision would apply to interviews conducted on or after 30 days after enactment.

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[1] These provisions are modifications to S. 2223 as reported by the Finance Committee. The Finance Committee held markup sessions on the Taxpayer Bill of Rights (S. 2223) on March 18 and 21, 1988, and reported the bill on March 29, 1988 (S. Rept. 100-309).

(3) Taxpayers may rely on written advice of the IRS

Under present law, the IRS may abate administratively some penalties. The provision would require the IRS to abate any portion of any penalty that is attributable to erroneous written advice furnished by the IRS to a taxpayer, where such advice was specifically requested in writing by the taxpayer and reasonably relied upon, unless the taxpayer failed to provide adequate or accurate information when requesting the advice. The provision would be effective for advice requested on or after enactment.

(4) Taxpayer assistance orders

The Taxpayer Ombudsman administers the IRS Problem Resolution Program, which is designed to resolve a wide range of tax administration problems that are not remedied through normal operating procedures or administrative channels. The provision would provide the Taxpayer Ombudsman with statutory authority to issue a taxpayer assistance order (e.g., requiring release from levy of property of the taxpayer) if, in the determination of the Ombudsman, the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the IRS is administering the internal revenue laws. The provision would be effective upon enactment.

(5) Office of Inspector General

The Treasury Department has a nonstatutory Inspector General with internal audit and investigative responsibilities for the Department, except for its four law enforcement agencies: IRS, Secret Service, Customs Service, and the Bureau of Alcohol, Tobacco, and Firearms. These functions are performed at the IRS by the Inspection Division, which reports directly to the IRS Commissioner. The provision would establish a statutory Inspector General within the IRS. It would in addition establish a separate statutory Inspector General within the Treasury Department (with oversight responsibility over all other agencies within the Department). The provision would be effective upon enactment. (The provision was passed by the Senate on February 2, 1988, as part of S. 908, The Inspector General Act Amendments of 1988. The House of Representatives passed a modified version of this legislation on July 26, 1988.)

(6) Basis for evaluation of IRS employees

The IRS Manual prohibits the use of production quotas or goals based upon sums collected to evaluate IRS enforcement officers, appeals officers, and reviewers. The provision would statutorily prohibit the IRS from using records of tax enforcement results to evaluate enforcement officers, appeals officers, and reviewers or to impose or suggest production

quotas or goals. The provision would be effective for evaluations conducted on or after enactment.

(7) Procedures relating to IRS regulations

Under present law, the IRS publishes all regulations in the Federal Register. Before final regulations are promulgated, proposed regulations are issued and comments are invited from the public and Government agencies. The IRS also issues some regulations as temporary regulations, which generally are effective upon publication and remain in effect until replaced by final regulations. The provision would require the IRS to solicit comments from the Small Business Administration (SBA) after the publication of proposed regulations or before the promulgation of final regulations. The SBA would be allowed four weeks to provide its comments on the impact of the regulations on small businesses. Each time the IRS issued temporary regulations, it would be required to simultaneously issue those regulations in proposed form. Temporary regulations would be permitted to remain in effect for no more than two years after issuance. The provision would be effective for regulations issued after enactment.

(8) Explanation of tax liability and penalties

The IRS currently is not required to explain the basis for assessing penalties. The provision would require that all tax due notices or deficiency notices contain both a description of the basis for, and an identification of the amounts (if any) of, tax due, interest, and penalties. The provision would apply to mailings made after 180 days after enactment.

(9) Installment payment of tax liability

Under present law, the IRS is not required to enter into installment payment agreements with taxpayers, but generally does so if a taxpayer who is unable to pay the delinquency in full is able to make payments on the delinquent taxes and pay current taxes as they become due. The provision would grant the IRS statutory authority to enter into a written installment payment agreement if the IRS determines that an agreement will facilitate collection of tax owed. The IRS would have authority to modify or terminate an installment payment agreement if the IRS determines that the financial condition of the taxpayer has significantly changed and if notice is given to the taxpayer at least 30 days prior to the date of action. The provision would apply to installment agreements entered into after enactment.

(10) Assistant Commissioner for Taxpayer Services

There is currently within the IRS an Assistant

Commissioner (Taxpayer Services and Returns Processing). This position is not provided by statute. The provision would establish an Assistant Commissioner for Taxpayer Services who, jointly with the Taxpayer Ombudsman, would be required to report annually to Congress concerning the quality of taxpayer services provided by the IRS. The provision would be effective upon enactment.

(11) Levy and distraint

Notice to taxpayers.--Present law provides that, at least 10 days before collecting a tax by levy, the IRS must provide the taxpayer written notice of its intent to levy. If the IRS finds that collection of tax is in jeopardy, it may collect the tax by levy without providing notice or waiting 10 days. The provision would extend the 10-day notice and waiting period to 30 days. As under present law, the notice and waiting period requirements would not apply if the collection of tax is in jeopardy.

Property subject to levy.--Property subject to levy includes any property belonging to the taxpayer, except property specifically excluded, which includes (1) fuel, provisions, furniture, and personal household effects, not exceeding $1,500 in aggregate value; and (2) books and tools necessary for the trade, business, or profession of the taxpayer, not exceeding $1,000 in aggregate value. The provision would index for inflation through 1990 the dollar value of both of these exclusions. The provision also would exempt from levy a taxpayer's principal residence and tangible personal property essential to the taxpayer's trade or business, unless an IRS district director or assistant director personally approves the levy in writing or the collection of tax is found to be in jeopardy. The provision also would prohibit levies in cases where the estimated expenses of levy and sale exceed the fair market value of the property.

Levy on wages.--Present law provides that the IRS may instruct the taxpayer's employer to pay directly to the IRS wages payable to the taxpayer, except (1) wages necessary to comply with a prior judgment of a court for support of minor children, and (2) a minimum amount of wages or other income (in general, $75 per week plus $25 per week for each dependent). The provision would increase the amount of wages exempt from levy for each week to an amount equal to the taxpayer's standard deduction and personal exemptions allowable for the taxable year in which the levy occurs, divided by 52.

Release of levy.--The IRS currently has authority to release a levy if it determines that this will facilitate the collection of tax. The provision would require the IRS to release a levy on property if (1) the liability for which the

levy was made is satisfied, (2) the IRS determines that release will facilitate the collection of the liability, (3) an installment payment agreement has been executed with respect to such liability, (4) the IRS has determined that the levy is creating an economic hardship due to the taxpayer's financial condition, or (5) the fair market value of the property exceeds the liability and partial release would not hinder collection of the tax and related costs owed to the IRS. The provision would be effective for levies issued more than 90 days after enactment.

(12) Review of jeopardy levy and assessment procedures

Present law provides special rules relating to administrative review and judicial review (by Federal district courts) of jeopardy assessments. These rules do not apply to jeopardy levies. The provision would extend the existing rules relating to review of jeopardy assessments to review of jeopardy levies. The Tax Court would be provided jurisdiction concurrent with Federal district courts with respect to the challenges to a jeopardy assessment or jeopardy levy if the taxpayer has filed a petition with the Tax Court prior to the making of the assessment or levy with respect to any deficiency covered by the jeopardy assessment or jeopardy levy notice. The provision would apply to jeopardy levies issued and jeopardy assessments made after enactment.

(13) Administrative appeal of liens

Under present law, although a taxpayer can obtain a review within the IRS of an initial determination of tax deficiency, there is no statutory procedure for the administrative appeal of IRS decisions concerning the collection of a tax liability. The provision would require the IRS to promulgate regulations within 180 days after enactment that provide taxpayers with an administrative procedure to obtain review of the filing of a notice of lien in the public record and an opportunity to petition for the release of such lien.

(14) Awarding of costs and certain fees in administrative and civil actions

Recoverable costs.--Under present law, any person who is a prevailing party in a tax case in any Federal court may be awarded reasonable litigation costs if the position of the United States was not substantially justified, but costs incurred during the IRS administrative process generally are not recoverable. The provision would provide that any person who substantially prevails in any tax case brought by or against the United States may be awarded reasonable litigation costs incurred in connection with any court proceeding and reasonable administrative costs incurred

before the IRS, but only if such administrative costs were incurred after the earlier of (1) the date of the first notice of proposed deficiency that allows the person an opportunity for administrative review in the IRS Office of Appeals, or (2) the date of the notice of deficiency described in section 6212 of the Code.

Burden of proof.--Under present law, in order to obtain reasonable litigation costs, the taxpayer must establish that the position of the United States in the case was not substantially justified. The provision would shift the burden of proof to the Government to establish that its position was substantially justified in order to prevent a prevailing taxpayer from recovering costs.

Position of the United States.--Under present law, in determining whether the position of the United States was substantially justified, the position is determined beginning with the position in the civil proceeding, or, if applicable, the position taken by the IRS district counsel administratively. This generally does not include positions taken in the audit or appeals process. The provision would provide that in determining whether the position of the United States was substantially justified, the position of the United States is any position taken after the later of (1) the date of the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Appeals Office, or (2) the date by which the relevant evidence under the control of the taxpayer, as well as relevant legal arguments, with respect to such action have been presented by the taxpayer to IRS examination or Service Center personnel.

Administrative settlement of claims for litigation costs.--The Code presently does not provide explicit authority to the IRS to settle administratively claims for litigation costs prior to the commencement of the civil action. The provision would provide the IRS with authority to settle claims for administrative costs and litigation costs. The provision would apply to actions commenced after enactment.

(15) Civil cause of action for damages due to failure to release lien

Under present law, the Code does not grant taxpayers a right to bring an action for damages resulting from the wrongful failure to remove a lien on a taxpayer's property. The provision would grant taxpayers the right to sue the Federal Government in Federal district court or Tax Court if any IRS employee knowingly or negligently fails to release a lien on the taxpayer's property as required under the Code. Taxpayers would be permitted to recover the costs of the action and damages equal to the greater of (1) the actual

direct economic damages sustained by the taxpayer which, but for the actions of the IRS, would not have been sustained, or (2) $100 per day (up to $1000) for each day the failure continues during the period that begins ten days after the taxpayer provides written notice to the IRS of the failure to release the lien. The provision would apply to taxpayer notices provided and damages arising after enactment.

(16) Civil cause of action for damages due to unreasonable action by the IRS

Under present law, taxpayers do not have a specific right to bring an action against the Government for damages sustained due to unlawful actions taken by an IRS employee. The provision would grant taxpayers the right to sue the Federal Government in Federal district court or Tax Court for damages if in connection with the determination or collection of any Federal tax, an officer or employee of the IRS carelessly, recklessly, or intentionally disregards any provision of Federal law or any regulation promulgated under the Internal Revenue Code. The taxpayer could recover the costs of the action plus actual direct economic damages sustained by the taxpayer as a proximate result of the unlawful actions or inaction of the IRS employee. The provision would apply to actions of IRS officers or employees that occur after enactment.

(17) Jurisdiction to restrain certain premature assessments

Under present law, jurisdiction to restrain IRS assessment and collection of tax rests solely with the Federal district courts. The provision grants the Tax Court jurisdiction (concurrent with Federal district courts) to restrain the assessment and collection of any tax by the IRS if the tax is the subject of a timely filed petition pending before the Tax Court. The provision would apply to orders entered after enactment.

(18) Jurisdiction to enforce overpayment determinations

Under present law, if the IRS fails to refund an overpayment determined by the Tax Court, the taxpayer must seek relief in another court. The provision would grant the Tax Court jurisdiction to order the refund of an overpayment plus interest if, within 120 days after a Tax Court decision has become final, the IRS fails to refund to a taxpayer an overpayment determined by the Tax Court. The provision would apply to overpayments determined by the Tax Court which have not been refunded by the 90th day after enactment.

(19) Jurisdiction to review certain sales of seized property

Under present law, if a taxpayer wishes to contest an IRS determination to sell property seized pursuant to a

jeopardy assessment, the only recourse is to bring suit in Federal district court. The provision would grant the Tax Court jurisdiction during the pendency of proceedings before it to review the IRS' determination to sell property seized pursuant to a jeopardy assessment. The provision would be effective on the 90th day after enactment.

(20) Jurisdiction to redetermine interest on deficiencies

Under present law, if, following a decision by the Tax Court, a taxpayer disagrees with the IRS' interest computation, the Tax Court does not have jurisdiction to resolve that dispute. The provision would permit a taxpayer, within one year from the date the Tax Court decision becomes final, to move to reopen the Tax Court proceeding for a determination of interest due. The provision would apply to assessments of deficiencies made after enactment.

(21) Jurisdiction to modify decisions in certain estate tax cases

Under present law, certain estates which consist largely of an interest in a closely held business may elect to pay Federal estate tax over an extended-payment period. If such an election is made, the amount of the estate tax deduction for interest to which an estate is entitled cannot be determined until the interest is paid, and the Tax Court may not enter a final judgment in the case until the extended-payment period has expired. The provision would grant the Tax Court authority to enter a final decision in an estate tax case in which an extended-payment period is elected and subsequently, if necessary, modify the decision at the end of the extended-payment period to reflect interest actually paid by the estate. The provision would apply to Tax Court cases for which the decision is not final on the date of enactment.

(22) Refund jurisdiction for the Tax Court

Under present law, the Tax Court has no jurisdiction to determine whether a taxpayer has made an overpayment except in the context of a deficiency proceeding. If the IRS rejects a taxpayer's refund claim, or does not act within six months, then the taxpayer may bring an action for refund in Federal district court or the United States Claims Court, but not in the Tax Court. The provision would grant the Tax Court jurisdiction over tax refund actions against the IRS where there is already pending and awaiting submission for disposition by a judge a deficiency action in the Tax Court, and where the issue in the refund action is related by subject matter to the deficiency action or the result in either of the two actions will affect the amount in controversy in the related action. All proceedings in the Tax Court would be stayed for 180 days if a refund action is

filed in the Tax Court and there is a showing by the IRS that there has been no audit of the taxpayer's return for the period or type of tax involved in the refund action. The general prerequisites governing the commencement of tax refund actions would apply to refund actions filed in the Tax Court. A taxpayer would continue to have the option of filing a claim for refund in the appropriate Federal district court or the United States Claims Court. The provision would apply to proceedings commenced in the Tax Court six months after enactment.

B. Modification of Low-Income Housing Credit Provisions

(1) Inclusion of certain additional amounts in credit base

The tax credit is determined by reference to the basis of the low-income housing units. Basis is determined on the date the property is placed in service. The proposal would include in basis for credit purposes costs that are added to the depreciable basis of the building within sixty days after the property is placed in service. The proposal would apply to property place in service after December 31, 1988.

(2) Eligible populations for the low-income housing credit

Clarification would be provided to allow low-income housing projects which serve primarily elderly or homeless populations to satisfy the general public requirement of the low-income housing credit. All other restrictions including the rule against the provision of substantial services would still be applicable. The proposal would apply to property placed in service after December 31, 1988. (Subject to revenue.)

(3) Committee report language on qualification of condominiums, etc. as credit property

The low-income credit is available for multifamily residential rental projects and also for single-family rental housing. In the case of single family houses, each house is a separate credit project. Clarification would be included that individually owned condominiums or townhouses may qualify as credit property on the same basis as detached, single-family houses. The proposal would apply as if included in the Tax Reform Act of 1986.

(4) Safe-harbor for certain carryforwards of credit allocations permitted

In general, a building must be placed in service in the year in which a credit allocation is received from the applicable State housing agency. Allocations may be carried forward to the succeeding year where the delay in placing the building in service is due to unforeseeable circumstances beyond the owner's control. The proposal would clarify that certain circumstances not representing or action or nonaction traceable to the developer, e.g., labor strikes, breaches of contract by subcontractors, unanticipated weather conditions, or significant litigation meet this standard. The proposal would apply to credit allocations made in years after 1987.

C. Repeal Uniform Capitalization Rules for Free-Lance Authors, Photographers, and Artists

Under present law, uniform capitalization rules generally apply to the production of all tangible personal property and to the purchase and holding of property for resale. The proposal would exempt from the uniform capitalization rules any otherwise deductible expense that is paid or incurred by an individual engaged in the business of being a writer, photographer, or artist. The exemption would apply only to the individual whose personal efforts create or may reasonably be expected to create a literary manuscript, musical composition, dance score, photograph, photographic negative or transparency, picture, painting, sculpture, statue, etching, drawing, cartoon, graphic design, or original print edition. The exemption would also apply to expenses of a personal service corporation that directly relate to the activities of a qualified employee-owner if such expenses would qualify for the exemption had they been paid or incurred directly by the employee-owner.

The proposal would be effective as if included in the Tax Reform Act of 1986.

D. Repeal Uniform Capitalization Rules for Certain Producers of Animals; Depreciation of Certain Farm Property

1. Uniform capitalization rules for producers of animals

Under present law, the uniform capitalization rules apply to the production of an animal in a farming business if (1) the animal has a preproductive period of more than two years or (2) the taxpayer engaged in the farming business is a corporation, partnership or tax shelter that is required to use an accrual method of accounting. The proposal would exempt from the uniform capitalization rules otherwise deductible expenses that are incurred by a taxpayer in connection with the production of animals in any farming business other than a farming business of a corporation, partnership or tax shelter that is required to use an accrual method of accounting.

The proposal would apply to costs incurred after December 31, 1988.

2. Depreciation of certain farm property

Under present law, property with recovery periods of less than 15 years may be depreciated using the 200 percent declining balance method. A special rule for farming businesses subject to the capitalization rules on pre-productive expenses which elect to deduct these pre-productive expenses requires them to depreciate assets using the alternative depreciation system. Also, single-purpose agricultural structures are assigned a 7-year recovery period. The proposal would make the 150-percent declining balance method the applicable depreciation method for property used in a farming business. The exception requiring farming businesses still subject to the pre-productive capitalization rules which elect to deduct these expenses to use the alternative depreciation system would still apply. In addition, the recovery period for single-purpose agricultural structures would be ten-and-one-half years.

The proposal would generally apply to property placed in service after December 31, 1988.

E. Extend Mortgage Revenue Bonds Through June 30, 1989

Qualified mortgage bonds (QMBs) are tax-exempt bonds the proceeds of which generally are used to make mortgage loans to first-time homebuyers. QMBs are issued subject to the State private activity volume limitations. As an alternative to QMBs, States and local governments may elect to trade bond authority available under the State's private activity volume limitation and issue mortgage credit certificates (MCCs). MCCs may be issued to the same persons who qualify for QMB financing. Authority to issue QMBs and to trade bond authority to issue MCCs expires after December 31, 1988. The proposal would extend the QMB and MCC for six months, through June 30, 1989.

The proposal would be effective on the date of the bill's enactment.

F. Extension of Exclusion for Employer-Provided Educational Assistance Through 1988

Under present law, an individual may (subject to the two-percent floor on nonreimbursed employee expenses) deduct from income amounts expended for education if the education is job-related (sec. 162). Education generally is job-related if it (1) maintains or improves skills required for the employee's job, or (2) meets the express requirements of the individual's employer that are imposed as a condition of continued employment in the same job. Job-related education expenses that are reimbursed by an individual's employer are excludable from gross income. Educational assistance provided by the employer that is not job-related is includible in income.

Under prior law (taxable years beginning before January 1, 1988), an employee's gross income for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee (without regard to whether the education was job-related) if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (sec. 127). This exclusion, which expired for taxable years beginning after December 31, 1987, was limited to $5,250 of educational assistance with respect to an individual during a calendar year and did not apply to education involving sports, games, or hobbies.

Under the proposal, the exclusion under section 127 for educational assistance would be restored retroactively to the date of expiration and would be extended so that it would expire for taxable years beginning after December 31, 1988. However, the exclusion under section 127 would not apply to any payment for, or the provision of any benefits with respect to, any graduate level courses of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or similar advanced academic or professional degree. For this purpose, the phrase "graduate-level course" means a course taken by an individual who (1) has received a bachelor's degree (or the equivalent thereof), or (2) is receiving credit toward a more advanced degree. This graduate education rule would not apply to graduate teaching or research assistants who receive tuition reduction under section 117(d), i.e., the scholarship rules. This graduate education rule also would not affect an employee's ability to exclude from income employer-provided job-related educational assistance.

In addition, the proposal would clarify the definition of education ineligible for the section 127 exclusion--i.e., education involving sports, games, or hobbies. Under this clarification, education with respect to a subject commonly considered a sport, game, or hobby, such as photography or

gardening, would be ineligible for the exclusion unless such education (1) has a reasonable relationship to an activity maintained by the employee for profit; (2) has a reasonable relationship to the business of the employer; or (3) is required as part of a degree program. Of course, education meeting these criteria may fail to be eligible for the exclusion for other reasons (such as the graduate education rule described above).

Also, it was unclear under prior law whether the prohibition on providing employees with a choice between nontaxable educational assistance benefits under section 127 and other remuneration includible in gross income prohibited the provision of taxable and nontaxable educational assistance benefits from a single trust. The proposal would clarify in legislative history the prior-law rules so that it is permissible to pay taxable and nontaxable educational assistance benefits from the same trust.

The proposal generally would be effective as of the date of the expiration of the exclusion. However, the provisions with respect to hobbies and payments from the same trust would be considered retroactive clarifications of prior law.

G. Extension of Exclusion for Employer-Provided Group Legal Services Through 1988

Under prior law, amounts contributed by an employer to a qualified group legal services plan for an employee (or the employee's spouse or dependents) were excluded from the employee's gross income for income and employment tax purposes (sec. 120). The exclusion also applied to any services received by an employee (or the employee's spouse or dependents) or any amounts paid to an employee under such a plan as reimbursement for the cost of legal services for the employee (or the employee's spouse or dependents). In order for the exclusion to apply, the group legal services plan was required to fulfill certain requirements. The exclusion for group legal services benefits expired for taxable years ending after December 31, 1987.

In addition, under prior law, an organization, the exclusive function of which was to provide legal services or indemnification against the cost of legal services as part of a qualified group legal services plan, was entitled to tax-exempt status (sec. 501(c)(20)). The tax exemption for such an organization expired for taxable years ending after December 31, 1987.

Under the proposal, the exclusion for group legal services and the section 501(c)(20) exemption would be restored retroactively to the date of expiration and would be extended so that they would expire for taxable years ending after December 31, 1988. However, under the proposal, the exclusion of the premium value of any insurance-type protection against legal expenses for any individual in a taxable year would be limited to $70. This limit would apply to the premium value of a plan (whether insured or self-insured) but not to the reimbursements or services provided under the plan.

In addition, under the proposal, the provision under a tax-exempt trust of group legal services benefits that are in excess of the $70 limit and taxable solely for that reason would not cause the trust to lose its tax-exempt status.

Also, for taxable years ending before January 1, 1989, the provision under a cafeteria plan of a group legal services benefit that is taxable solely because of the $70 cap would be considered the provision of a qualified benefit (sec. 125(e)) and thus would not disqualify the cafeteria plan.

This proposal would be effective as of the date of the expiration of the exclusion and exemption.

H. Extension of Special Student Loan Bond Arbitage Rules through June 30, 1989

Generally arbitrage profits earned on nonpurpose investments acquired with the gross proceeds of any tax-exempt bond must be rebated to the United States. In addition, temporary periods when bond proceeds may be invested in higher yielding investments are statutorily limited for pooled financing bonds. The Tax Reform Act of 1986 provided an exemption from these requirements for certain qualified student loan bonds issued before January 1, 1989. The proposal would provide a 6-month extension of these special rules. The proposal would be effective on the date of the bill's enactment.

I. Extension of Business Energy Tax Credits for Solar, Geothermal and Ocean Thermal Property Through June 30, 1989

Under present law, three business energy tax credits are scheduled to expire after December 31, 1988:

(1) Business solar--10% credit
(2) Geothermal--10% credit
(3) Ocean thermal--15% credit.

These credits were extended in the Tax Reform Act of 1986 through 1988, with the tax credit rates effective in 1988 as shown above.

Under the proposal, these credits would be extended through June 30, 1989, at the present (1988) tax credit rates. The extension of the present energy tax credit rates would become effective on January 1, 1989.

J. Extension Of Modified Targeted Jobs Tax Credit Through June 30, 1989

The present-law targeted jobs tax credit provides a tax credit to employers for hiring individuals from nine targeted groups. The credit is 85 percent of the first $3000 of wages paid to disadvantaged summer youth employees, and 40 percent of the first $6000 of wages paid to all other qualified individuals. The credit is available for individuals who begin work before January 1, 1989.

The proposal would extend the credit for individuals who begin work before July 1, 1989. In addition, the proposal would reduce the disadvantaged summer youth credit percentage from 85 percent to 40 percent.

The proposal would be effective for individuals who begin work after December 31, 1988 and before July 1, 1989.

K. Extension of Tax Credit for Research Expenditures; Modification of Deduction for Research Expenditures

1. Extension of research credit

The present-law research credit (including the university basic research credit), which is scheduled to expire after December 31, 1988, would be extended for six additional months, i.e., through June 30, 1989. A pro rata rule would apply for purposes of computing the extended credit, pursuant to which the taxpayer's qualified research expenditures (or basic research payments) for January 1, 1989 through June 30, 1989 would be deemed equal to one-half the taxpayer's qualified research expenditures (or basic research payments) for calendar year 1989.

2. Expensing of research expenditures

No deduction (under sec. 174 or otherwise) would be allowed for that portion of a taxpayer's qualified research expenses or basic research payments that equals the amount of the taxpayer's research credit for that year. The provision would be effective for taxable years beginning after December 31, 1988.

L. Extension and Modification of Allocation and Apportionment Rules for R&D Expenses

The degree to which a U.S. taxpayer that pays foreign income taxes can take advantage of the foreign tax credit depends, in part, on the proportion of its entire worldwide taxable income that is from foreign sources. Expenses that may relate to both U.S. source and foreign source gross income (such as R&D expenses) must be allocated and apportioned among U.S. and foreign sources in order to arrive at the relevant proportion of foreign source taxable income to worldwide taxable income. For certain taxable years beginning before August 14, 1981 and for taxable years beginning after August 1, 1987, R&D expenses were and are allocated under detailed Treasury regulations promulgated for this purpose in 1977. The regulation is designed to allocate and apportion R&D expenses on the basis of their respective contributions to U.S source and foreign source net income.

For the intervening taxable years indicated above, R&D expenses were allocated and apportioned under statutory rules designed with particular emphasis on encouraging the conduct of R&D in the United States. This result was accomplished by enacting temporary rules that generally allocated more U.S. incurred R&D expenses to U.S. source gross income than would have been allocated under the 1977 regulation. The statutory methods thus tended to boost any taxpayer's proportion of foreign source taxable income to worldwide taxable income, in many cases allowing the foreign tax credit for foreign income taxes that otherwise would not have been creditable.

Under the proposal, a new statutory allocation method, designed to provide an additional tax incentive to perform R&D in the United States, would be temporarily effective for the first four months of the taxpayer's first taxable year beginning after August 1, 1987. (In determining which R&D expenses were incurred in which four-month period of that taxable year, R&D expenses would be treated as if incurred ratably throughout the taxable year.) The proposed method would allow U.S. persons to allocate 64 percent of U.S. R&D expenses (other than any such amounts allocated to one geographical source because of legal requirements) to U.S. source income. Similarly, U.S. persons would allocate 64 percent of expenses for R&D conducted outside the United States (other than any such amount allocated to one geographical source because of legal requirements) to foreign source income. The remainder of U.S. and foreign R&D expenses would be allocated on the basis of gross sales or (subject to a limit) gross income. The amount of R&D expense allocated to foreign source income on the basis of gross income would in all cases be at least 30 percent of the amount allocated to foreign source income on the basis of gross sales.

M. Financially Troubled Thrift Institutions: Reorganizations, NOLs, and FSLIC Assistance Payments

Under present law, three special rules enacted in the Economic Recovery Tax Act of 1981, and repealed as of December 31, 1988, by the Tax Reform Act of 1986, apply to financially troubled thrift institutions:

(1) under section 597 of the Code, gross income of a domestic savings and loan association does not include amounts received from the Federal Savings and Loan Insurance Corporation ("FSLIC") under its financial assistance program, and no basis reduction is required on account of the receipt of such assistance payments;

(2) under section 368(a)(3)(D) of the Code, certain FSLIC assisted acquisitions of financially troubled thrift institutions are permitted to qualify as tax-free reorganizations, without regard to the continuity of interest requirement; and

(3) under section 382(l)(5)(F), special rules apply to the carryover of net operating losses, built-in losses, and excess credits of a thrift institution that has a certain ownership changes.

The proposal would generally extend the special present law rules for financially troubled thrift institutions for six months, through June 30, 1989, and would expand these provisions to include financially troubled banks and payments made to such banks by the Federal Deposit Insurance Corporation ("FDIC").

In general, assistance payments made by FSLIC and FDIC would be tax exempt by reason of section 597. However, to the extent of 50 percent of such assistance payments, there would be a reduction in deductions for loan portfolio built-in losses and net operating losses existing at the time of the regulatory assistance, and interest expense.

In the case of asset acquisitions, if section 597 does not apply to any assistance payment, there will be no reduction in any deductions. However, in all other cases involving FSLIC or FDIC assistance payments, including, for example, periodic maintenance payments and lump sum payments, there would be a reduction of the losses or the interest deduction equal to 50 percent of the assistance payments.

The proposal would be effective as follows:

(1) The extension of section 368(a)(3)(D) would apply to acquisitions after December 31, 1988, and before July 1, 1989;

(2) The extension of section 597 would apply to assistance payments after December 31, 1988, and before July 1, 1989, except that the extension also would apply to assistance payments made pursuant to acquisitions occurring before July 1, 1989; and

(3) The extension of section 382(l)(5)(F) would apply to any equity structure shifts or transactions occurring after December 31, 1988, and before July 1, 1989.

N. Controlled Foreign Insurance Corporations Owned by U.S. Persons

Under present law, foreign corporations engaged in the insurance business in the United States are subject to the branch level taxes even where those corporations are controlled by U.S. persons. If such corporations were reorganized as U.S. corporations they could avoid the branch tax, but would potentially be subject to a tax on accumulated earnings and profits. This tax results from the general rule that when a U.S.-controlled foreign corporation is reorganized as a U.S. corporation, certain accumulated earnings and profits of the foreign corporation must be taxed in order for the reorganization to be considered a nonrecognition event.

Under the proposal, controlled foreign corporations engaged in the insurance business could make an election to be treated as a U.S. corporation, thereby avoiding the branch level taxes, so long as certain conditions and requirements are met. Dividends paid by an electing corporation would be eligible for the dividends received deduction to the extent paid out of earnings and profits for periods that the election is in effect. In lieu of paying an immediate U.S. tax on earnings and profits accumulated prior to the election, the proposal would provide for a tax equal to three-quarters of one percent of capital and surplus (but limited to $1,500,000.) of any foreign corporation that elects to be treated as a U.S. corporation. The proposal would be effective for taxable years beginning after December 31, 1987.

O. One-Year Delay In Implementing Changes In Depreciable Lives

Under present law, the Treasury Department generally has the authority to establish or change the class lives of depreciable assets. The Tax Reform Act of 1986 established an office in Treasury to monitor and analyze actual experience of tangible depreciable assets and to report its findings to the Secretary who can then prescribe new depreciable lives for these assets. Certain assets may not have their lives adjusted or lengthened before January 1, 1992.

The proposal would require a one-year delay between the time that the Secretary proposes a lengthening of an asset's class life and the effective date of such change. This proposal would be effective upon enactment.

P. Pension Reversions of Qualified Plan Assets

Under present law, a 10 percent excise tax is imposed on an employer reversion from a qualified plan (sec. 4980). The proposal would temporarily increase the excise tax from 10 percent to 60-percent. Present-law exceptions to the excise tax, such as the exception for certain transfers of reversions to an employee stock ownership plan, would continue to be exempt from the increased excise tax. In addition, the proposal would require that the excise tax be paid by the employer by the end of the month following the month in which the reversion occurs. The increase in the excise tax would apply with respect to reversions received after July 26, 1988, and before May 1, 1989. However, the increase in the excise tax would not apply to reversions pursuant to a plan termination if (1) with respect to plans subject to Title IV of ERISA, a notice of intent to terminate required under section 4041(b) of ERISA was provided to participants before July 27, 1988, (2) with respect to plans subject to Title I of ERISA, a notice of intent to reduce future accruals required under section 204(h) of ERISA was provided to participants in connection with the termination before July 27, 1988, or (3) with respect to plans not subject to Title I or Title IV of ERISA, the board of directors of the employer approved the termination or the employer took similar binding action before July 27, 1988. The acceleration of time for payment of the tax would apply to reversions received on or after May 1, 1989.